

# **FIRST QUARTER 2004**

Management's Discussion and Analysis of  
Financial Condition and Results of Operations.....2

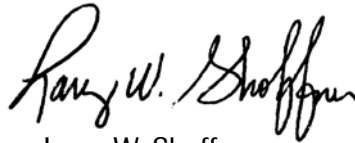
Consolidated Financial Statements

Consolidated Balance Sheets.....4

Consolidated Statements of Income.....5

Consolidated Statements of Changes in Members' Equity.....6

Notes to the Consolidated Financial Statements.....7



Larry W. Shoffner  
Chief Executive Officer



Bobby E. McCollum, Jr.  
Chairman of the Board

April 29, 2004

# Management's Discussion and Analysis of Financial Condition and Results of Operations

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of Carolina Farm Credit, ACA (Association) for the period ended March 31, 2004. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2003 Annual Report of the Association.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including part-time farm, poultry, and rural home loans. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, has an impact on the level of dependency on a given agricultural commodity.

The gross loan volume of the Association as of March 31, 2004, was \$1,070,167, an increase of \$17,308 as compared to \$1,052,859 at December 31, 2003. Net loans outstanding at March 31, 2004, were \$1,048,530 as compared to \$1,030,911 at December 31, 2003. Net loans accounted for 95.85 percent of total assets at March 31, 2004, as compared to 95.41 percent of total assets at December 31, 2003.

The increase in gross and net loan volume during the reporting period is attributed primarily to seasonal lending. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in August and rapidly declines in the fall months as farm commodities are marketed and proceeds are applied to the operating loans.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, however, and credit administration remains satisfactory. Nonaccrual loans decreased from \$6,734 at December 31, 2003, to \$6,652 at March 31, 2004. This decrease is primarily the result of repayments and transfer to other property owned in excess of transferring loans into nonaccrual status.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at March 31, 2004, was \$21,637 compared to \$21,948 at December 31, 2003, and was considered by management to be adequate to cover possible losses.

In June, 2003, the American Institute of Certified Public Accountants' Accounting Standards Executive Committee (AcSEC) issued a proposed Statement of Position (SOP) – Allowance for Credit Losses, which was intended to clarify the methodology for estimating the allowance for credit losses and to enhance financial statement disclosures related to the allowance for credit losses. In January 2004, AcSEC abandoned its proposed SOP and announced that it would focus instead on improving financial statement disclosures regarding the allowance for loan losses.

We plan to conduct a study to further refine our methodology for calculating the allowance for loan losses taking into account generally accepted accounting principles, and applicable Farm Credit Administration requirements, as well as the Securities and Exchange Commission and Federal Financial Institutions Examination Council guidelines. The study is likely to be completed by the fourth quarter of 2004 with any appropriate reduction to the allowance for loan losses implemented at that time, which reduction may be significant.

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## RESULTS OF OPERATIONS

### *For the three months ended March 31, 2004*

Net income for the three months ended March 31, 2004, totaled \$4,833, as compared to \$5,047 for the same period in 2003. Net interest income increased \$51, for the three months ended March 31, 2004, as compared to the same period in 2003.

At March 31, 2004, interest income on loans decreased \$954 compared to March 31, 2003. Nonaccrual income was \$123 for the three months ended March 31, 2004, as compared to \$158 for the same period in 2003. Interest expense decreased \$1,005 for the three months ended March 31, 2004, as compared to the comparable period of 2003.

Noninterest income for the three months ended March 31, 2004, totaled \$2,420, as compared to \$2,977 for the same period of 2003, a decrease of \$557. This decline in earning is attributed to a decrease of \$501 in loans fees and \$173 in noninterest income other when compared to the same period in 2003. These declines were offset by an increase of \$3 in fees for financially related services, \$81 in earnings of AgFirst Farm Credit Bank (the Bank), \$33 in gains on other property owned when compared to the same period in 2003.

Noninterest expense for the three months ended March 31, 2004, decreased \$24 compared to the same period of 2003. Included in noninterest expense of \$5,039 were operating expenses totaling \$5,039. Operating expenses decreased \$24 over the same period in 2003 primarily due to the salaries and employee benefits. The major components of operating expenses for the Association are salaries and employee benefits, building depreciation and general office expenses. The provision for income taxes for the three months ended March 31, 2004 decreased \$18 compared to the same period of 2003.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the

Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at March 31, 2004, was \$915,419 as compared to \$904,991 at December 31, 2003. The increase during the period is attributable to new borrowing by the Association for funds advanced to its borrowers.

The Association had no lines of credit outstanding with third parties as of March 31, 2004.

## CAPITAL RESOURCES

Total members' equity at March 31, 2004, increased to \$151,024 from the December 31, 2003, total of \$146,286. The change in capital is attributed to net earnings for the three months ending March 31, 2004.

Total capital stock and participation certificates were \$9,878 on March 31, 2004, compared to \$9,905 on December 31, 2003. This decrease is attributable to the retirement of protected and at-risk stock and participation certificates on loans liquidated in the normal course of business and new loans being capitalized at new lower regulatory levels.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of March 31, 2004, the Association's total surplus ratio and core surplus ratio were 14.08 percent and 10.36 percent, respectively, and the permanent capital ratio was 14.99 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

*Carolina Farm Credit, ACA*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>March 31, 2004</b>	<b>December 31, 2003</b>
	<i>(unaudited)</i>	
<b>Assets</b>		
Cash	\$ 1,294	\$ 1,353
Loans	1,070,167	1,052,859
Less: allowance for loan losses	21,637	21,948
Net loans	1,048,530	1,030,911
Accrued interest receivable	11,069	10,109
Investment in other Farm Credit institutions	14,184	14,191
Premises and equipment, net	8,927	8,778
Other property owned	1,241	369
Deferred tax asset, net	1,661	1,661
Other assets	7,079	13,172
Total assets	<u>\$ 1,093,985</u>	<u>\$ 1,080,544</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 915,419	\$ 904,991
Accrued interest payable	3,115	3,144
Patronage refund payable	522	4,681
Postretirement benefits other than pensions	7,811	7,475
Minimum pension liability	6,199	5,708
Other liabilities	9,895	8,259
Total liabilities	<u>942,961</u>	<u>934,258</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	1,069	1,288
Capital stock and participation certificates	8,809	8,617
Retained earnings		
Allocated	87,116	86,999
Unallocated	65,231	60,583
Accumulated other comprehensive income (loss)	(11,201)	(11,201)
Total members' equity	<u>151,024</u>	<u>146,286</u>
Total liabilities and members' equity	<u>\$ 1,093,985</u>	<u>\$ 1,080,544</u>

*The accompanying notes are an integral part of these financial statements.*

*Carolina Farm Credit, ACA*  
**Consolidated Statements of Income**  
*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>Interest Income</b>		
Loans	\$ 16,730	\$ 17,684
<b>Interest Expense</b>		
Notes payable to AgFirst Farm Credit Bank	9,274	10,279
Net interest income	7,456	7,405
Provision for (reversal of) loan losses	—	250
Net interest income after provision for (reversal of) loan losses	7,456	7,155
<b>Noninterest Income</b>		
Loan fees	497	998
Fees for financially related services	133	130
Equity in earnings of AgFirst Farm Credit Bank	1,710	1,629
Gains (losses) on other property owned, net	49	16
Other noninterest income	31	204
Total noninterest income	2,420	2,977
<b>Noninterest Expense</b>		
Salaries and employee benefits	3,384	3,492
Occupancy and equipment	410	375
Insurance Fund premium	253	292
Other operating expenses	992	904
Total noninterest expense	5,039	5,063
Income before income taxes	4,837	5,069
Provision (benefit) for income taxes	4	22
Net income	\$ 4,833	\$ 5,047

*The accompanying notes are an integral part of these financial statements.*

*Carolina Farm Credit, ACA*  
**Consolidated Statements of Changes in  
Members' Equity**

*(unaudited)*

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
<i>(dollars in thousands)</i>						
Balance at December 31, 2002	\$ 1,739	\$ 8,814	\$ 81,979	\$ 63,669	\$ (12,107)	\$ 144,094
Net income				5,047		5,047
Protected borrower equity retired	(306)					(306)
Capital stock/participation certificates issued		207				207
Capital stock/participation certificates retired		(2)				(2)
Retained earnings retired			(20)			(20)
Distribution adjustment			2,483	(2,673)		(190)
Balance at March 31, 2003	\$ 1,433	\$ 9,019	\$ 84,442	\$ 66,043	\$ (12,107)	\$ 148,830
Balance at December 31, 2003	\$ 1,288	\$ 8,617	\$ 86,999	\$ 60,583	\$ (11,201)	\$ 146,286
Net income				4,833		4,833
Protected borrower equity retired	(219)					(219)
Capital stock/participation certificates issued		195				195
Capital stock/participation certificates retired		(3)				(3)
Distribution adjustment			117	(185)		(68)
Balance at March 31, 2004	\$ 1,069	\$ 8,809	\$ 87,116	\$ 65,231	\$ (11,201)	\$ 151,024

*The accompanying notes are an integral part of these financial statements.*

Carolina Farm Credit, ACA

# Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)  
(unaudited)

## NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Carolina Farm Credit, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2003, are contained in the 2003 Annual Report to Stockholders. These unaudited first quarter 2004 consolidated financial statements should be read in conjunction with the 2003 Annual Report to Stockholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the three months ended March 31, 2004, are not necessarily indicative of the results to be expected for the year ending December 31, 2004.

Certain amounts in prior period consolidated financial statements have been reclassified to conform to current consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of March 31, 2004, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

## NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

Balance at 12-31-02	\$ 21,571
(Reversal of) provision for loan losses	250
Loans (charged off), net of recoveries	<u>—</u>
Balance at 3-31-03	<u>\$ 21,821</u>
Balance at 12-31-03	\$ 21,948
(Reversal of) provision for loan losses	—
Loans (charged off), net of recoveries	<u>(311)</u>
Balance at 3-31-04	<u>\$ 21,637</u>

## NOTE 3 – EMPLOYEE BENEFIT PLANS

The Association participates in a Districtwide defined benefit retirement plan. The costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times each institution's salary expense as a percentage of the District's salary expense. The Association also participates in Districtwide Thrift and other postretirement benefit plans.

The following is a table of retirement and postretirement benefit expense for the three months ended March 31, 2004:

	For the three months ended March 31,	
	2004	2003
Pension	\$ 491	\$ 515
Thrift/deferred compensation	62	65
Other postretirement benefits	490	465
Total	<u>\$ 1,043</u>	<u>\$ 1,045</u>